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Statements on Auditing Standards

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1976

# Special reports; Statement on auditing standards, 014

American Institute of Certified Public Accountants. Auditing Standards Executive Committee

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## Recommended Citation

American Institute of Certified Public Accountants. Auditing Standards Executive Committee, "Special reports; Statement on auditing standards, 014" (1976). *Statements on Auditing Standards*. 11.  
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## Special Reports<sup>1</sup>

*(Supersedes Statement on Auditing Standards No. 1, section 620)*

1. This Statement applies to auditors' reports issued in connection with—
- a. Financial statements that are prepared in accordance with a comprehensive basis of accounting other than generally accepted accounting principles (paragraphs 2-8).
  - b. Specified elements, accounts, or items of a financial statement (paragraphs 9-17).
  - c. Compliance with aspects of contractual agreements or regulatory requirements related to audited financial statements (paragraphs 18-19).

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<sup>1</sup>This Statement amends the second sentence of section 410.02 of SAS No. 1 by the addition of the following footnote:

When an auditor reports on financial statements prepared in accordance with a comprehensive basis of accounting other than generally accepted accounting principles, the first standard of reporting is satisfied by disclosing in the auditor's report that the statements are not intended to conform with generally accepted accounting principles and by expressing an opinion (or disclaiming an opinion) on whether the financial statements are presented in conformity with the comprehensive basis of accounting used (see SAS No. 14, "Special Reports," paragraphs 2 through 8).

This Statement also amends section 518.03 of SAS No. 1, to read as follows:

Negative assurances also are permissible in special reports relating to (a) the results of applying agreed-upon procedures to one or more specified elements, accounts, or items of a financial statement and (b) compliance with aspects of contractual agreements or regulatory requirements related to audited financial statements. (See SAS No. 14, "Special Reports," paragraphs 15 through 19.)

- d. Financial information presented in prescribed forms or schedules that require a prescribed form of auditor's report (paragraphs 20-21).

Reports that meet the foregoing criteria are *special reports* or *special purpose reports*. This Statement does not apply to reports issued in connection with (a) limited reviews of interim financial information, (b) financial forecasts, projections, or feasibility studies, or (c) compliance with aspects of contractual agreements or regulatory requirements unrelated to financial statements.

### **Reports on Financial Statements Prepared in Accordance With a Comprehensive Basis of Accounting Other Than Generally Accepted Accounting Principles**

2. Generally accepted auditing standards are applicable when an auditor examines and reports on any financial statement.<sup>2</sup> The term *financial statement* refers to a presentation of financial data, including accompanying notes, derived from accounting records and intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a comprehensive basis of accounting. For reporting purposes, the independent auditor should consider each of the following types of financial presentations to be a financial statement:

- a. Balance sheet.
- b. Statement of income.
- c. Statement of retained earnings.
- d. Statement of changes in financial position.
- e. Statement of changes in owners' equity.
- f. Statement of assets and liabilities that does not include owners' equity accounts.
- g. Statement of revenue and expenses.
- h. Summary of operations.
- i. Statement of operations by product lines.
- j. Statement of cash receipts and disbursements.

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<sup>2</sup>A financial statement may be, for example, that of a corporation, a consolidated group of corporations, a combined group of affiliated entities, a not-for-profit organization, a government unit, an estate or trust, a partnership, a proprietorship, a segment of any of these, or an individual.

3. An independent auditor's judgment concerning the overall presentation of financial statements needs to be applied within an identifiable framework (see SAS No. 5, "The Meaning of 'Present Fairly in Conformity With Generally Accepted Accounting Principles' in the Independent Auditor's Report"). Normally the framework is provided by generally accepted accounting principles, and the auditor's judgment in forming an opinion is applied accordingly (see SAS No. 5, paragraph 4). In some circumstances, however, a comprehensive basis of accounting other than generally accepted accounting principles may be used.

4. For purposes of this Statement, a comprehensive basis of accounting other than generally accepted accounting principles is a basis to which at least one of the following descriptions applies:

- a. A basis of accounting that the reporting entity uses to comply with the requirements or financial reporting provisions of a government regulatory agency to whose jurisdiction the entity is subject. Examples are a basis of accounting prescribed in a uniform system of accounts that the Interstate Commerce Commission requires railroad companies to use and a basis of accounting insurance companies use pursuant to the rules of a state insurance commission.
- b. A basis of accounting that the reporting entity uses or expects to use to file its income tax return for the period covered by the financial statements.
- c. The cash receipts and disbursements basis of accounting, and modifications of the cash basis having substantial support, such as recording depreciation on fixed assets or accruing income taxes.
- d. A definite set of criteria having substantial support that is applied to all material items appearing in financial statements, such as the price-level basis of accounting described in Accounting Principles Board Statement No. 3.

Unless one of the foregoing descriptions applies, reporting under the provisions of paragraph 5 is not permitted.

5. When reporting on financial statements prepared in accordance with a comprehensive basis of accounting other than generally accepted accounting principles, as defined in paragraph 4, an independent auditor should include all of the following in his report:

- a. A paragraph identifying the financial statements examined and

stating whether the examination was made in accordance with generally accepted auditing standards.

b. A paragraph that—

- (i) States, or preferably refers to the note to the financial statements that states, the basis of presentation of the financial statements on which the auditor is reporting.
- (ii) Refers to the note to the financial statements that describes how the basis of presentation differs from generally accepted accounting principles. (The monetary effect of such differences need not be stated.)
- (iii) States that the financial statements are not intended to be presented in conformity with generally accepted accounting principles.

c. A paragraph that expresses the auditor's opinion (or disclaims an opinion) on whether—

- (i) The financial statements are presented fairly in conformity with the basis of accounting described.<sup>3</sup> If the auditor concludes that the financial statements are not presented fairly on the basis of accounting described, he should disclose all the substantive reasons for that conclusion in an additional explanatory paragraph(s) of his report and should include in the opinion paragraph appropriate modifying language and a reference to the explanatory paragraph(s).
- (ii) The disclosed basis of accounting used has been applied in a manner consistent with that of the preceding period.

When reporting on financial statements prepared in accordance with the requirements or financial reporting provisions of a government regulatory agency (see paragraph 4a), the auditor may use the form of reporting prescribed in this paragraph only if the financial statements are intended solely for filing with a regulatory agency or if additional distribution is recognized as appropriate by an AICPA accounting or audit guide or auditing interpretation.<sup>4</sup>

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<sup>3</sup>In reporting on financial statements prepared on a comprehensive basis of accounting other than generally accepted accounting principles, the auditor should consider whether the financial statements (including the accompanying notes) include all informative disclosures that are appropriate for the basis of accounting used.

<sup>4</sup>In view of the provisions of this paragraph, the third sentence of section 544.02 of SAS No. 1 is amended by the addition of the following footnote:

6. Unless the financial statements are intended to be presented in accordance with a “comprehensive basis of accounting other than generally accepted accounting principles” (as defined in paragraph 4), the auditor should use the standard form of report (see SAS No. 2, “Reports on Audited Financial Statements,” paragraph 7), modified as appropriate (see SAS No. 2, paragraphs 15 through 17) because of the departures from generally accepted accounting principles.

7. Terms such as “balance sheet,” “statement of financial position,” “statement of income,” “statement of operations,” “statement of changes in financial position,” or similar unmodified titles are generally understood to be applicable only to financial statements that are intended to present financial position, results of operations, or changes in financial position in conformity with generally accepted accounting principles. Consequently, the auditor should consider whether the financial statements he is reporting on are suitably titled. For example, a cash-basis financial statement might be titled “statement of assets and liabilities arising from cash transactions,” or “statement of increases or decreases in funds arising from cash transactions,” and a financial statement prepared on a statutory or regulatory basis might be titled “statement of income—statutory basis.” If the auditor believes that the financial statements are not suitably titled, he should modify his report to disclose his reservations.

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When reporting on financial statements of a regulated company that are prepared in accordance with the requirements or financial reporting provisions of a government regulatory agency to whose jurisdiction the company is subject, the auditor may report on the financial statements as being prepared in accordance with a comprehensive basis of accounting other than generally accepted accounting principles (see SAS No. 14, “Special Reports,” paragraphs 2 through 8). Reports of this nature, however, should be issued only if the financial statements are intended solely for filing with the regulatory agency or if additional distribution is recognized as appropriate by an AICPA accounting or audit guide or auditing interpretation.

Also, section 544.04 of SAS No. 1 is amended to read as follows:

When financial statements of a regulated company are prepared in accordance with a basis of accounting prescribed by its supervisory agency or the financial reporting provisions of another agency, the independent auditor may also be requested to report on their fair presentation in conformity with such prescribed basis of accounting in presentations other than filings with the company’s regulatory agency. In those circumstances, except when such reporting is recognized as appropriate by an AICPA accounting or audit guide or auditing interpretation, the auditor should use the standard form of report (see SAS No. 2, “Reports on Audited Financial Statements,” paragraph 7), modified as appropriate (see SAS No. 2, paragraphs 15 through 17) because of the departures from generally accepted accounting principles, and then, in an additional paragraph to the report, express an opinion on whether the financial statements are presented in conformity with the prescribed basis of accounting.

8. The following are illustrations of reports on financial statements prepared in accordance with a comprehensive basis of accounting other than generally accepted accounting principles.

*Financial Statements Prepared on a Basis Prescribed by a Regulatory Agency Solely for Filing With That Agency<sup>5</sup>*

We have examined the statement of admitted assets, liabilities, and surplus—statutory basis of XYZ Insurance Company as of December 31, 19XX, and the related statements of income—statutory basis and changes in surplus—statutory basis for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As described in Note X, the Company's policy is to prepare its financial statements on the basis of accounting practices prescribed or permitted by the Insurance Department of [State]. These practices differ in some respects from generally accepted accounting principles. Accordingly, the accompanying financial statements are not intended to present financial position and results of operations in conformity with generally accepted accounting principles. This report is intended solely for filing with regulatory agencies and is not intended for any other purpose.

In our opinion, the financial statements referred to above present fairly the admitted assets, liabilities and surplus of XYZ Insurance Company as of December 31, 19XX, and the results of its operations and changes in its surplus for the year then ended, on the basis of accounting described in Note X, which basis has been applied in a manner consistent with that of the preceding year.

*Financial Statements Prepared on the Entity's Income Tax Basis*

We have examined the statement of assets, liabilities, and capital—income tax basis of ABC Partnership as of December 31, 19XX, and the related statements of revenue and expenses—income tax basis and of changes in partners' capital accounts—income tax basis for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As described in Note X, the Partnership's policy is to prepare its financial statements on the accounting basis used for income tax pur-

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<sup>5</sup>See paragraph 5 concerning what additional distribution of the financial statements or the auditor's report is appropriate.

poses; consequently, certain revenue and the related assets are recognized when received rather than when earned, and certain expenses are recognized when paid rather than when the obligation is incurred. Accordingly, the accompanying financial statements are not intended to present financial position and results of operations in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly the assets, liabilities, and capital of ABC Partnership as of December 31, 19XX, and its revenue and expenses and changes in its partners' capital accounts for the year then ended, on the basis of accounting described in Note X, which basis has been applied in a manner consistent with that of the preceding year.

### *Financial Statements Prepared on the Cash Basis*

We have examined the statement of assets and liabilities arising from cash transactions of XYZ Company as of December 31, 19XX, and the related statement of revenue collected and expenses paid for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As described in Note X, the Company's policy is to prepare its financial statements on the basis of cash receipts and disbursements; consequently, certain revenue and the related assets are recognized when received rather than when earned, and certain expenses are recognized when paid rather than when the obligation is incurred. Accordingly, the accompanying financial statements are not intended to present financial position and results of operations in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly the assets and liabilities arising from cash transactions of XYZ Company as of December 31, 19XX, and the revenue collected and expenses paid during the year then ended, on the basis of accounting described in Note X, which basis has been applied in a manner consistent with that of the preceding year.

## **Reports on Specified Elements, Accounts, or Items of a Financial Statement**

9. An independent auditor may be requested to report on one or more specified elements, accounts, or items of a financial statement. In such an engagement, the specified element(s), account(s), or item(s) may be presented in the report or in a document accompany-



ing the report. Such a report normally falls into one of the following categories.

- a. A report expressing an opinion on one or more specified elements, accounts, or items of a financial statement, such as rentals, royalties, a profit participation, or a provision for income taxes (see paragraphs 10-14).
- b. A report relating to the results of applying agreed-upon procedures to one or more specified elements, accounts, or items of a financial statement (see paragraphs 15-17).

**Reports Expressing an Opinion on One or More Specified Elements, Accounts, or Items of a Financial Statement**

10. In reporting on one or more specified elements, accounts, or items of a financial statement, the auditor should plan his examination and prepare his report with a view to the purpose of the engagement. The general standards, the standards of field work, and the third and fourth standards of reporting are applicable to an engagement to express an opinion on one or more specified elements, accounts, or items of a financial statement; however, since specified elements, accounts, or items of a financial statement are not considered to be a financial statement, the first standard of reporting does not apply. The second standard of reporting as to consistency is applicable if the elements, accounts, or items on which the auditor is to express an opinion are prepared in accordance with generally accepted accounting principles. Examples of items that ordinarily are not prepared in accordance with generally accepted accounting principles are those prepared in accordance with the provisions of a contract, law, or government regulation.

11. An engagement to express an opinion on one or more specified elements, accounts, or items of a financial statement may be undertaken as a separate engagement or in conjunction with an examination of financial statements. In such an engagement, an auditor expresses his opinion on each of the specified elements, accounts, or items encompassed by his report; therefore, the measurement of materiality must be related to each individual element, account, or item examined rather than to the aggregate thereof or to the financial statements taken as a whole. Consequently, an examination of a specified element, account, or item for purposes of reporting thereon is usually more extensive than if the same information were being

considered in conjunction with an examination of financial statements taken as a whole. Also, many financial statement elements are interrelated, for example, sales and receivables; inventory and payables; buildings and equipment, and depreciation. The auditor should satisfy himself that elements, accounts, or items that are interrelated with those on which he has been engaged to express an opinion have been considered in expressing his opinion.

12. The auditor should not report on specified elements, accounts, or items included in financial statements on which he has expressed an adverse opinion or disclaimed an opinion based on an audit, if such reporting would be tantamount to expressing a piecemeal opinion on the financial statements (see SAS No. 2, paragraph 48). However, in those circumstances, an auditor would be able to report on one or more specified elements, accounts, or items of a financial statement provided that the matters to be reported on and the related scope of the examination were not intended to and did not encompass so many elements, accounts, or items as to constitute a major portion of the financial statement. Also, the report should not accompany the financial statements of the entity.

13. When an independent auditor is engaged to express an opinion on one or more specified elements, accounts, or items of a financial statement, such as rentals, royalties, a profit participation, or a provision for income taxes, his report should—

- a. Identify the specified elements, accounts, or items examined.
- b. State whether the examination was made in accordance with generally accepted auditing standards and, if applicable, that it was made in conjunction with an examination of financial statements. (Also, if applicable, any modification of the auditor's standard report on those statements should be indicated.)
- c. Identify the basis on which the specified elements, accounts, or items are presented and, when applicable, any agreements specifying such basis.
- d. Describe and indicate the source of significant interpretations made by the client in the course of the engagement relating to the provisions of a relevant agreement.
- e. Indicate whether in his opinion the specified elements, accounts, or items are presented fairly on the basis indicated.

- f. If applicable, indicate whether in his opinion the disclosed basis has been applied in a manner consistent with that of the preceding period.

When expressing an opinion on one or more specified elements, accounts, or items of a financial statement, the auditor, to provide more information as to the scope of his examination, may wish to describe certain auditing procedures applied.

14. The following are illustrations of reports expressing an opinion on one or more specified elements, accounts, or items of a financial statement.

*Report Relating to Amount of Sales for the Purpose of Computing Rental*

Board of Directors  
ABC Company

We have examined the schedule of gross sales (as defined in the lease agreement dated March 4, 19XX, between ABC Company, as lessor, and XYZ Stores Corporation, as lessee) of XYZ Stores Corporation at its Main Street store, [City], [State], for the year ended December 31, 19XX. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the schedule of gross sales referred to above presents fairly the gross sales of XYZ Stores Corporation at its Main Street store, [City], [State], for the year ended December 31, 19XX, on the basis specified in the lease agreement referred to above.

*Report Relating to Royalties*

Board of Directors  
XYZ Corporation

We have examined the schedule of royalties applicable to engine production of the Q Division of XYZ Corporation for the year ended December 31, 19XX, under the terms of a license agreement dated May 14, 19XX, between ABC Company and XYZ Corporation. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

We have been informed that, under XYZ Corporation's interpretation of the agreement referred to above, royalties were based on the number of engines produced after giving effect to a reduction for production retirements that were scrapped, but without a reduction for field returns that were scrapped, even though the field returns were replaced with new engines without charge to customers. This treatment is consistent with that followed in prior years.

In our opinion, the schedule of royalties referred to above presents fairly the number of engines produced by the Q Division of XYZ Corporation during the year ended December 31, 19XX, and the amount of royalties applicable thereto under the license agreement referred to above, on the basis indicated in the preceding paragraph.

### *Report on a Profit Participation<sup>6</sup>*

Mr. John Smith  
City, State

We have examined XYZ Company's schedule of John Smith's profit participation for the year ended December 31, 19X1. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We have examined the financial statements of XYZ Company for the year ended December 31, 19X1, and have issued our report thereon dated March 10, 19X2.

We have been informed that the documents that govern the determination of John Smith's profit participation are (a) the employment agreement between John Smith and XYZ Company dated February 1, 19X0, (b) the production and distribution agreement between XYZ Company and Television Network Incorporated dated March 1, 19X0, and (c) the studio facilities agreement between XYZ Company and QRX Studios dated April 1, 19X0, as amended November 1, 19X0.

In our opinion, the schedule of profit participation referred to above presents fairly John Smith's participation in the profits of XYZ Company for the year ended December 31, 19X1, in accordance with the provisions of the agreements referred to in the preceding paragraph.

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<sup>6</sup>A report on an examination of a schedule of profit participation should be issued only if the auditor has examined the financial statements on which the participation is based.

*Report Relating to the Adequacy of a Provision for  
Income Taxes in Financial Statements<sup>7</sup>*

Board of Directors  
XYZ Company, Inc.

We have examined the financial statements of XYZ Company, Inc., for the year ended June 30, 19XX, and have issued our report thereon dated August 15, 19XX. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In the course of our examination, we examined the provision for federal and state income taxes for the year ended June 30, 19XX, included in the Company's financial statements referred to in the preceding paragraph. We also reviewed the federal and state income tax returns filed by the Company that are subject to examination by the respective taxing authorities.

In our opinion, the Company has paid or has provided adequate accruals in the financial statements referred to above for the payment of all federal and state income taxes, and has provided for related deferred income taxes, applicable to fiscal 19XX and prior fiscal years, that could be reasonably estimated at the time of our examination of the financial statements of XYZ Company, Inc., for the year ended June 30, 19XX.

**Reports Relating to the Results of Applying Agreed-Upon Procedures to Specified Elements, Accounts, or Items of a Financial Statement**

15. When the scope of an engagement is limited to applying, to one or more specified elements, accounts, or items of a financial statement, agreed-upon procedures that are not sufficient to enable the accountant to express an opinion on the specified elements, ac-

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<sup>7</sup>A report relating to the adequacy of a provision for income taxes in financial statements should be issued only if the auditor has examined the financial statements in which the provision appears.

If a significant period of time has elapsed between the date of the auditor's report on the financial statements and the date he is reporting on the provision for income taxes, the auditor may wish to include the following paragraph in his report:

Because we have not examined any financial statements of XYZ Company, Inc., as of any date or for any period subsequent to June 30, 19XX, we have no knowledge of the effects, if any, on the income tax provision of events that may have occurred subsequent to the date of our examination.

counts, or items, he should so state in his report. Acceptance of such an engagement is appropriate only if (a) the parties involved have a clear understanding of the procedures<sup>s</sup> to be performed, (b) distribution of the report is to be restricted to named parties involved, and (c) financial statements of the entity are not to accompany the report. The accountant's report should (a) indicate the specified elements, accounts, or items to which the agreed-upon procedures were applied, (b) indicate the intended distribution of the report, (c) enumerate the procedures performed, (d) state the accountant's findings, (e) disclaim an opinion with respect to the specified elements, accounts, or items, and (f) state that the report should not be associated with the financial statements of the entity. If the accountant has no adjustments to propose to the specified elements, accounts, or items, the report may include a comment to that effect. For example, the following language might be included in the report: "In connection with the procedures referred to above, no matters came to our attention that caused us to believe that the (specified elements, accounts, or items) should be adjusted." Also, the accountant may wish to indicate that had he performed additional procedures with respect to the specified elements, accounts, or items, or had he made an examination of the financial statements in accordance with generally accepted auditing standards, (other) matters might have come to his attention that would have been reported.

16. The second and third standards of field work and the standards of reporting do not apply to an engagement that is limited to applying agreed-upon procedures to one or more specified elements, accounts, or items of a financial statement; however, the general standards and the first standard of field work are applicable.

17. The following are illustrations of the types of reports that might be issued when an engagement is limited to applying agreed-upon procedures to one or more specified elements, accounts, or items of a financial statement.

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<sup>s</sup>Mere reading of a specific element, account, or item does not constitute a procedure sufficient to permit an accountant to report on the results of applying agreed-upon procedures to one or more specified elements, accounts, or items of a financial statement.

*Report in Connection With a Proposed Acquisition*

Board of Directors  
 X Company

We have applied certain agreed-upon procedures, as discussed below, to accounting records of Y Company, Inc., as of December 31, 19XX, solely to assist you in connection with the proposed acquisition of Y Company, Inc. It is understood that this report is solely for your information and is not to be referred to or distributed to anyone not a member of management of X Company for any purpose. Our procedures and findings are as follows:

- a. We reconciled cash on deposit with the following banks to the balances in the respective general ledger accounts and obtained confirmation of the related balances from the banks.

<i>Bank</i>	<i>Balance Per General Ledger</i>
ABC National Bank	\$ 5,000
DEF State Bank	13,776
XYZ Trust Company— regular account	86,912
XYZ Trust Company— payroll account	5,000

- b. We obtained an aged trial balance of the accounts receivable subsidiary records; traced the age and amounts of approximately 10 percent of the accounts to the accounts receivable ledger; added the trial balance and compared the total with the balance in the general ledger control account. We mailed requests for positive confirmation of balances to 150 customers; differences disclosed in confirmation replies were minor in amount and nature, and we reconciled them to our satisfaction. The results are summarized as follows:

	<i>Accounts Receivable Aging and Confirmation</i>		
	<i>Account Balance</i>	<i>Confirmation Results Requested</i>	<i>Received</i>
Current .....	\$156,000	\$ 76,000	\$ 65,000
Past due:			
Less than one month .....	60,000	30,000	19,000
One to three months .....	36,000	18,000	10,000
Over three months .....	48,000	48,000	8,000
	\$300,000	\$172,000	\$102,000

Because the above procedures were not sufficient to constitute an

examination made in accordance with generally accepted auditing standards, we do not express an opinion on any of the specific accounts referred to above. In connection with the procedures referred to above, no matters came to our attention that caused us to believe that the [specified elements, accounts, or items] should be adjusted. Had we performed additional procedures or had we made an examination of the financial statements in accordance with generally accepted auditing standards, matters might have come to our attention that would have been reported to you. This report should not be associated with the financial statements of Y Company, Inc., for the year ended December 31, 19XX.

### *Report in Connection With Claims of Creditors*

Trustee  
XYZ Company

At your request, we have performed the procedures enumerated below with respect to the claims of creditors of XYZ Company as of May 31, 19XX, set forth in the accompanying schedules. Our review was made solely to assist you in evaluating the reasonableness of those claims, and our report is not to be used for any other purpose. The procedures we performed are summarized as follows:

- a. We compared the total of the trial balance of accounts payable at May 31, 19XX, prepared by the Company, to the balance in the Company's related general ledger account.
- b. We compared the claims received from creditors to the trial balance of accounts payable.
- c. We examined documentation submitted by the creditors in support of their claims and compared it to documentation in the Company's files, including invoices, receiving records, and other evidence of receipt of goods or services.

Except as is set forth in Schedule B, we found that amounts claimed by creditors and amounts shown in the Company's records were the same. Our findings are presented in the accompanying schedules. Schedule A lists claims that are in agreement with the Company's records. Schedule B lists claims that are not in agreement with the Company's records and sets forth the differences in amounts.

Because the above procedures were not sufficient to constitute an examination made in accordance with generally accepted auditing standards, we do not express an opinion on the accounts payable balance as of May 31, 19XX. In connection with the procedures referred to above, except as set forth in Schedule B, no matters came to our attention that caused us to believe that the accounts payable might



require adjustment. Had we performed additional procedures or had we made an examination of the financial statements in accordance with generally accepted auditing standards, other matters might have come to our attention that would have been reported to you. This report should not be associated with the financial statements of XYZ Company for the year ended May 31, 19XX.

### **Reports on Compliance With Aspects of Contractual Agreements or Regulatory Requirements Related to Audited Financial Statements**

18. Companies may be required by contractual agreements, such as bond indentures and certain types of loan agreements, or by regulatory agencies to furnish compliance reports by independent auditors. For example, loan agreements usually impose on borrowers a variety of covenants involving matters such as payments into sinking funds, payments of interest, maintenance of current ratio, restriction of dividend payments, and use of the proceeds of sales of property. They usually also require the borrower to furnish annual financial statements that have been examined by an independent auditor. In some instances, the lenders or their trustees may request assurance from the independent auditor that the borrower has complied with the covenants of the agreement relating to accounting or auditing matters. The independent auditor normally satisfies this request by giving negative assurance relative to the applicable covenants. This assurance may be given in a separate report or in one or more paragraphs of the auditor's report accompanying the financial statements. Such assurance, however, should not be given unless the auditor has examined the financial statements to which the contractual agreements or regulatory requirements relate.

19. The expression of negative assurance should specify that it is being given in connection with an examination of the financial statements. The auditor may also wish to state that the examination was not directed primarily toward obtaining knowledge regarding compliance. A separate report giving negative assurance should contain a paragraph stating that the financial statements have been examined, the date of the report thereon, and whether the examination was made in accordance with generally accepted auditing standards. The following are examples of reports that might be issued.

*Report on Compliance With Contractual Provisions  
Given in a Separate Report*

We have examined the balance sheet of XYZ Company as of December 31, 19X1, and the related statements of income, retained earnings, and changes in financial position for the year then ended, and have issued our report thereon dated February 16, 19X2. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In connection with our examination, nothing came to our attention that caused us to believe that the Company was not in compliance with any of the terms, covenants, provisions, or conditions of sections XX to XX, inclusive, of the Indenture dated July 21, 19X0, with ABC Bank. However, it should be noted that our examination was not directed primarily toward obtaining knowledge of such noncompliance.

*Report on Compliance With Contractual Provisions  
Given in Auditor's Report Accompanying Financial Statements*

We have examined the balance sheet of XYZ Company as of December 31, 19X1, and the related statements of income, retained earnings, and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of XYZ Company as of December 31, 19X1, and the results of its operations and changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

In connection with our examination, nothing came to our attention that caused us to believe that the Company was not in compliance with any of the terms, covenants, provisions, or conditions of sections XX to XX, inclusive, of the Indenture dated July 21, 19X0, with ABC Bank. However, it should be noted that our examination was not directed primarily toward obtaining knowledge of such noncompliance.

*Report on Compliance With Regulatory Requirements*

We have examined the balance sheet of XYZ Company as of December 31, 19X1, and the related statements of income, retained earnings,

and changes in financial position for the year then ended, and have issued our report thereon dated March 5, 19X2. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In connection with our examination, nothing came to our attention that caused us to believe that the Company had failed to comply with the limitation and increased investment requirement in section 993(d)(2) and (3) of the Internal Revenue Code of 1954. However, it should be noted that our examination was not directed primarily toward obtaining knowledge of noncompliance with such requirements.

## **Financial Information Presented in Prescribed Forms or Schedules**

20. Printed forms or schedules designed by the bodies with which they are to be filed often prescribe the wording of an auditor's report. Many of these forms are not acceptable to independent auditors because the prescribed form of auditor's report does not conform to the applicable professional reporting standards. For example, the prescribed language of the report may call for assertions by the auditor that are not consistent with his function or responsibility.

21. Some report forms can be made acceptable by inserting additional wording; others can be made acceptable only by complete revision. When a printed report form calls upon an independent auditor to make an assertion that he believes he is not justified in making, he should reword the form or attach a separate report. In those situations, the reporting provisions of paragraph 5 may be appropriate.

## **Effective Date**

22. Statements on Auditing Standards generally are effective at the time of their issuance. However, since the provisions of this Statement change certain reporting practices heretofore considered acceptable, this Statement will be effective with respect to engagements to issue special reports on data for periods beginning after December 31, 1976. For an entity having a fiscal year of 52 or 53 weeks ending in the last seven days in December or the first seven days in January, reference to December 31, 1976 means the date in

December or January on which the fiscal year ends. Earlier application of this Statement is encouraged, but not required.

*The Statement entitled "Special Reports" was adopted by the assenting votes of nineteen members of the Committee, of whom three, Messrs. Konkel, May, and Nelson, assented with qualifications. Messrs. Groveman and Ziegler dissented.*

Mr. Nelson approves the issuance of this Statement, but qualifies his assent because of certain provisions of paragraphs 4, 5, and 8.

He believes that the term "substantial support" in paragraph 4 is inappropriate and unclear in its practical application. With respect to paragraph 4d, he believes that the Committee should have either (1) not permitted such reporting, thereby continuing to require a qualified or adverse opinion on a GAAP basis, followed by an opinion on the basis presented or (2) permitted the paragraph 5 type reporting for financial statements prepared using a definite set of criteria applied to all material items appearing in the financial statements, whether or not such criteria have "substantial support." He believes the Committee, in not taking a definite stand, has created a provision which defies practical application.

Mr. Nelson believes that the provision stated at the end of paragraph 5 and repeated in the first example of paragraph 8 regarding restriction of financial statements is not practicable. Many financial statements filed with regulatory agencies become a matter of public record and therefore their use is not effectively restricted. He believes that no useful purpose is served by having two different auditor's reports on the same set of financial statements, one version for the copies filed with a regulatory agency and another version for management, creditors, and all other users (see footnote 4). He believes, in fact, that such reporting is confusing to users.

Mr. May approves the issuance of this Statement, but qualifies his assent because he objects to that part of paragraph 15 which permits a form of limited assurance by the accountant in a report relating to the results of applying "agreed-upon" procedures to specified elements, accounts, or items of a financial statement. In his opinion, while the extent of procedures can be "agreed-upon," there can be no meaningful communication of the inherent limitation of the review and the resultant limited assurances, since the same negative assurances might well be given after applying vastly different "agreed-upon" procedures.

Mr. Konkel approves the issuance of the Statement, but qualifies his assent to paragraphs 15-19 which continue to permit the use of "negative assurance," a form of reporting to which he is opposed because there are no defined procedures required to be performed to give such assurance. He believes that a form of positive assurance commensurate with the incisiveness of procedures performed is more appropriate.

Mr. Groveman dissents to the issuance of this Statement because he believes that it establishes a series of rules governing the issuance of various types of reports without setting forth an appropriate conceptual frame-

work. He believes that the Statement should discuss both the reporting objectives for each category of special report and the extent of auditing procedures contemplated in order for the auditor to state that his examination has been made in accordance with generally accepted auditing standards. He believes that, with respect to various types of reports described by the Statement, inadequate guidance is provided for application of the consistency standard, the nature and extent of disclosures that would be considered adequate, and the considerations that would influence the auditor's judgment concerning possible modifications or disclaimers of his opinions.

Mr. Ziegler dissents to the issuance of this Statement because he believes that it does not appropriately recognize generally accepted accounting principles as the hallmark of financial presentations. In his view, the methods and formats described in paragraph 4 do not generally depict comprehensive bases of accounting, but rather situations in which limited specific aspects of financial statements are not dealt with in accordance with generally accepted accounting principles. Accordingly, Mr. Ziegler does not agree with the conclusions set forth in paragraph 5. He believes that both the nature and monetary effect of material departures from generally accepted accounting principles must be disclosed in the financial statements or their footnotes if such disclosures are to be informative and adequate. Otherwise, this data should be referred to in the auditor's report as prescribed by the third standard of reporting.

### Auditing Standards Executive Committee (1975-1976)

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*Auditing Standards*

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*Auditing Standards*

**Note:** *Statements on Auditing Standards are issued by the Auditing Standards Executive Committee, the senior technical committee of the Institute designated to issue pronouncements on auditing matters. Rule 202 of the Institute's Code of Professional Ethics requires adherence to the applicable generally accepted auditing standards promulgated by the Institute. It recognizes Statements on Auditing Standards as interpretations of generally accepted auditing standards and requires that members be prepared to justify departures from such Statements.*